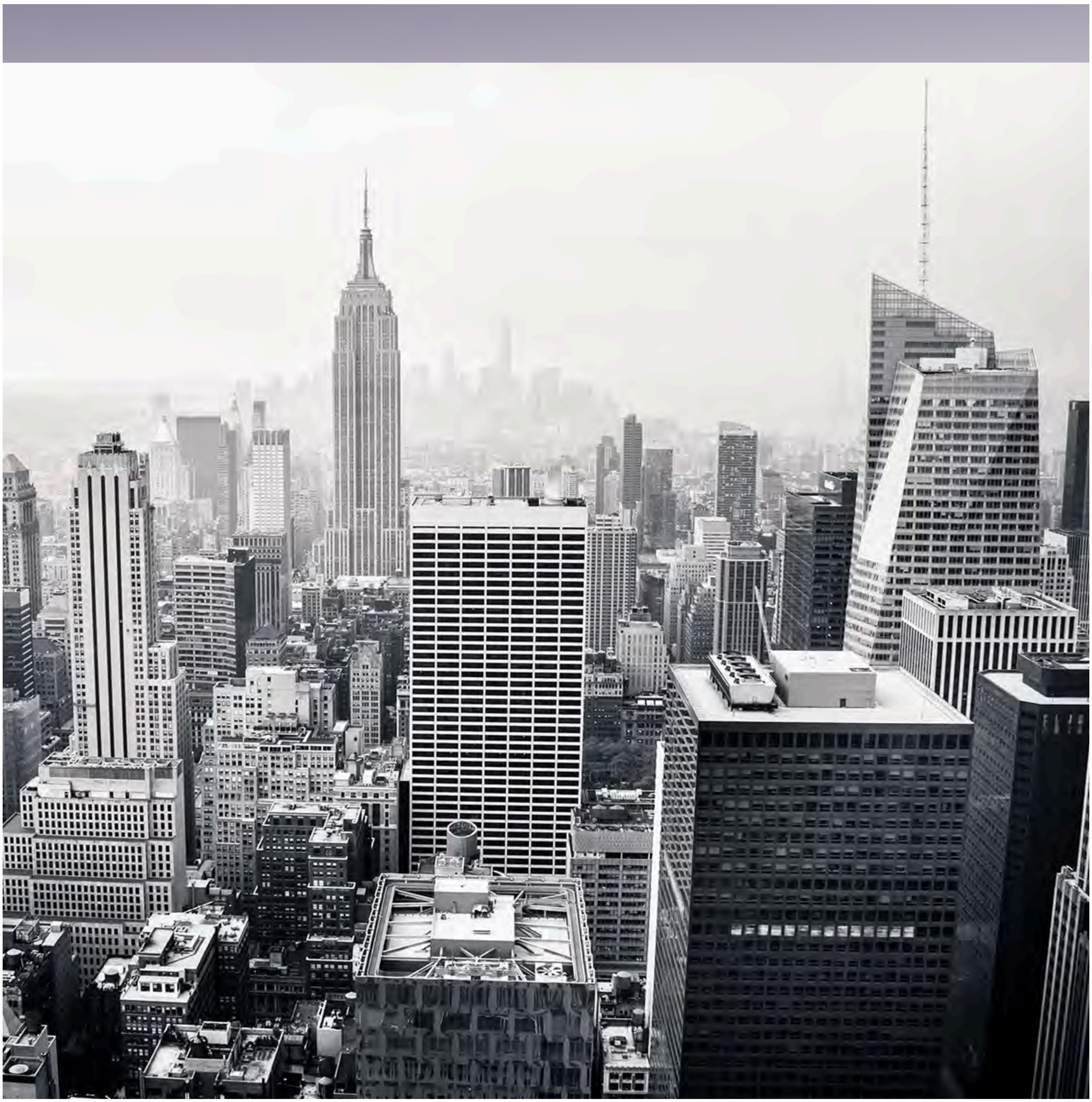
SICA | FLETCHER
Opportunities Abound

SELLING YOUR INSURANCE BUSINESS?

THE COSTLY MISTAKES OF DOING IT ALONE

Whitepaper



OVERVIEW

Selling an insurance agency in today's market can be a challenging and complex process. The growing number of institutional buyers and deal structures have made deals more complicated than ever.

One of the biggest mistakes an agency owner can make in the current environment is selling their business without representation. Many institutional buyers seek unrepresented sellers because they know they can acquire them at a deep discount. An analysis of deals by Sica | Fletcher found that, on average, owners selling their agencies without a broker typically do so for up to 30% lower valuations than similar agencies that use a sell-side representative.

AN EXPENSIVE MISTAKE: SELLING IN A ONE-OFF PROCESS

Selling an insurance agency is a complex endeavor that involves many moving pieces, variables, and components. One of agency owners' biggest mistakes is selling their business in a one-off process without receiving multiple bids from competitive buyers.

Strategic Buyers and Increasing Complexity

The growing number of buyers and deal structures have increased the complexity of the insurance business marketplace. Over the past decade, private equity-backed agencies have dominated the insurance brokerage sector, influencing transaction terms and pricing and leading to an explosion of insurance brokerage M&A transactions.

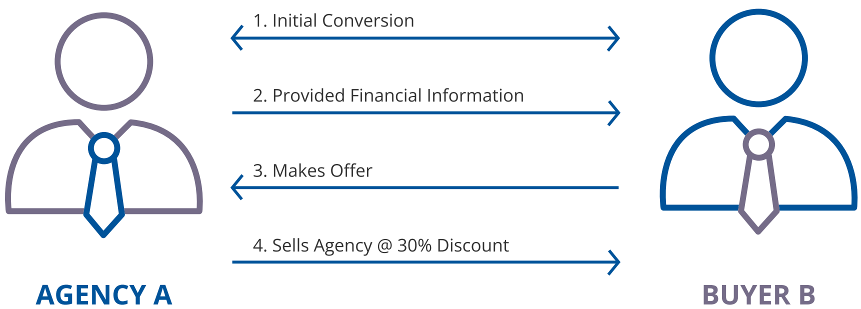
PE investors find the insurance brokerage industry highly attractive due to the predictable, renewable cash flows, high margins, and recession-resistant revenue streams. There are also many opportunities to acquire healthy small companies with no clear succession plans.

Many agency owners believe that because they are already successful salespeople, they have the skills and knowledge to find the best buyer for their business. However, simply finding a buyer is only one, and probably the easiest, part of a large and complicated transaction. Oftentimes, these owners fall into the trap of working with a single prospective buyer and doing a one-off deal where the buyer convinces them to sell outside of a competitive marketplace process.

Consider a typical scenario where an agency owner receives an unexpected call out of the blue with an offer to buy their business. Even if there was no initial intent to sell, savvy PE-backed buyers can court these agencies and ultimately propose what seems like an attractive deal. When a small agency owner with no succession plan and nearing retirement is suddenly presented with a multi-million dollar offer, quickly signing an agreement can feel like a no-brainer.

Because of this, Institutional buyers often target smaller agencies without a strategic advisor as they know they can typically land a deep discount when they have no other buyers to compete with. An agency in a one-off deal typically has no proper understanding of the market value of their business. Without any competition or incentive to make their best offer, the buyer can start at the bottom. Sica | Fletcher has seen many deals after the fact where agencies sold at more than a 30% discount without even realizing they were nowhere close to the actual market value of their business.

One-Off Deal



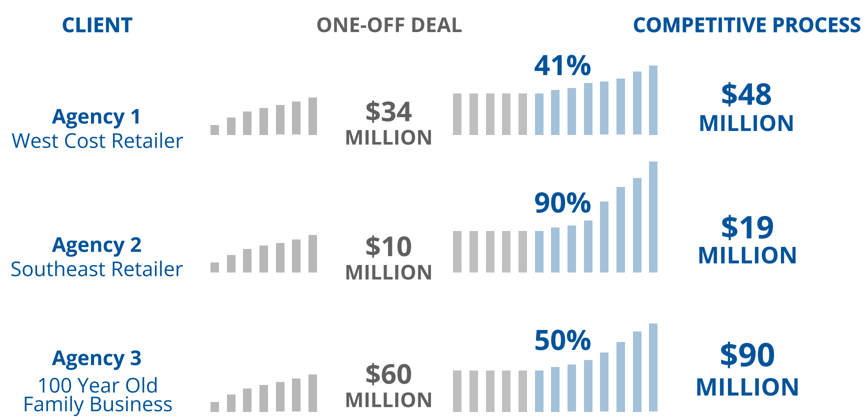
1. Agency thought they knew the value of their agency. They didn't.
2. With no competition, Buyer B is NEVER going to make their best offer.
3. Agency A sells at 30% plus discount.
4. Agency A will never realize what just happened.

While these same agency brokers wouldn't hesitate to hire an agent to sell their house, they often take a DIY approach to selling their business. Many believe they're saving on a sales commission, even though the amount pales in comparison to the value that an advisor can bring, not only to land a much better deal from an economic perspective but also to show a seller multiple options to find the best cultural fit.

Leaving Millions on the Table

Deals are increasingly complex, and there's much more to selling an insurance agency than agreeing on a purchase price. Sica | Fletcher is the #1 financial advisor in the industry and, since 2014, has closed on 310 sell-side assignments with more than $19 billion in transaction value.

Here are some examples where Sica | Fletcher has helped clients identify millions of dollars of value they would have otherwise left on the table:



EXAMPLE 1

In one case, a West Coast Retailer signed a letter of intent with a buyer with whom it had been in talks for over a year. However, prior to closing, the buyer became unreasonable around basic closing terms, causing the seller to get cold feet and seek an advisor.

Sica | Fletcher reviewed the deal and was able to run a competitive process and ultimately take the $34 million offer to $48 million at closing.

EXAMPLE 2

A Southeastern Retailer signed a letter of intent with a buyer, but their lawyer encouraged them to consult an advisor to take a second look. Sica | Fletcher determined the seller's EBITDA was far higher than what the buyer had calculated for the seller, as the seller wasn't even sure of its earnings. The seller presented these new findings and said it would prefer to market the deal to more prospective buyers. Rather than lose out on the deal, the buyer agreed to increase the purchase price by 90%, from $10 million to $19 million.

EXAMPLE 3

A 100-year-old family business had been on a long, drawn-out process with a buyer it thought was a perfect fit. The father had been continually courted by a buyer with whom he had a 10-year relationship. However, while the father agreed to the buyer's offer, the son reached out to Sica | Fletcher to ensure it was a good deal.

After Sica| Fletcher's review of the operations, growth, and profitability and by creating competition, the agency could sell its business to another for $90 million, 50% more than their initial offer of $60 million.

LESS THAN A 1% CHANCE OF FINDING THE RIGHT BUYER

Without running a competitive process or having an experienced negotiator on its behalf, the odds of a successful outcome and an agency getting the best deal for its business are severely limited.

Today, approximately 50 PE-backed brokers and six publicly traded insurance brokers are looking to acquire agencies and brokers. Consider an agency in talks with only one of those buyers; the odds of finding the right one is 1.8%. However, these buyers also have teams with years of experience in M&A and often do 50 or more deals per year, meaning the agency's odds of getting its best deal are stacked against them. In summary, the odds of an agency seller without a broker finding the right buyer *and* negotiating the best deal are less than 1%.

Nevertheless, sellers are accepting these odds every day. And because they have limited information and perspective, they often agree to deals that unnecessarily leave millions of dollars of generational wealth on the table.

While selling an insurance business is already challenging, it is becoming increasingly complex. One problem is the growth of PE-sponsored buyers and the rapid rise of interest rates in recent years have changed the characteristics of buyers. Many buyers also use a higher percentage of equity consideration, and there is more buyer rotation and ever-evolving capital structures.

Valuations are also increasingly complex and challenging for those without deal experience to understand. They are typically based on a multiple of pro forma EBITDA, which represents the guaranteed at the close purchase price. It does not include earnouts, holdbacks, stock appreciation, or other possible considerations. However, it's not just about the face value of the multiple but how that deal is structured. Take, for example, a seller with a $1 million EBITDA that agreed to a valuation of 10x EBITDA, or $10 million. In a deal like that, the buyer may offer $6 million in cash, and as long as the EBITDA stays flat for three years it will then pay the rest. Yet this is not really a $10 million deal, as the benchmark that Sica | Fletcher focuses on is what is guaranteed at closing. In this case, there's an 85% difference in terms of closing proceeds as compared to a deal with $10 million guaranteed at the transaction close.

BROKERING THE BEST DEAL

Leaving 30% on the table can have significant consequences, especially for small business owners who are exiting to provide legacy wealth to their families. Our research shows that while sellers face many challenges in today's market, they can also find opportunities by focusing on other rich components of value in addition to multiples of EBITDA.

A broker can also ensure a seller gets a sense of all the opportunities and validates new prospects, ensuring the transaction is better for employees, clients, and overall cultural fit.

There are many other issues to consider besides the overall headline purchase price. Most deals involve a combination of cash and stock, yet many owners aren't clear on exactly how much their stock is worth. Deals typically also require the business to leave a set amount of working capital. However, many business owners courted by these one-off buyers don't realize that until the end. In the case of a $5 million offering with a requirement to leave $275,000 in working capital, the actual sales price is $4,250,000.

FOR EXAMPLE

calculating pro-forma EBITDA can significantly impact the purchase price. An experienced advisor can run a competitive process, enabling the seller to control the calculation of the pro-forma EBITDA, the timing, and the due diligence. Creating a sense of pressure encourages buyers to offer more for the agency and enables the seller to make a more informed decision by speaking with buyers of all sizes, types, and personalities.

Business owners also have to consider how the money is paid. For instance, a $10 million purchase may offer $7.5 million paid at close and the rest over three to five years. Or, the buyer may demand to hold a set amount of bank funds for a certain amount to ensure there are no lawsuits.

Finally, a broker leads and manages a very complicated, multi-phase process for the seller, including understanding their own value, sorting through potential producer and employee challenges, initial investor meetings, interpreting offers, and managing the financial due diligence and the legal process. While it may be tempting to take what appears to be a generous offer in a quick deal, insurance agency owners are put themselves at a significant disadvantage selling without representation. Bringing expertise to the table helps them navigate the complexity to ensure they get the best deal and terms for their business.

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ABOUT SICA | FLETCHER

Sica | Fletcher is well known as the leading strategic and financial advisory firm in the U.S., specializing in the insurance brokerage space and related industries. We are also the leading advisor to the private equity firms most interested in investing in insurance brokerages and the private equity-sponsored agencies created in recent years.

The firm was founded in 2014 by Michael Fletcher and Al Sica, two of the industry's leading insurance M&A advisors who have closed over $19 billion in insurance agency and brokerage transactions since 2014. Sica | Fletcher has been ranked by S&P Global as the #1 insurance M&A advisory firm since 2017 in terms of total deals advised.

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